

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Northpointe Behavioral Healthcare System	County Dickinson
Audit Date 2/11/05	Opinion Date 9/30/04	Date Accountant Report Submitted to State: 4/18/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

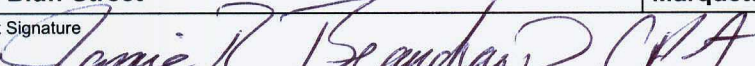
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | | |
|------------------------------|--|---|
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.			✓
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Makela, Toutant, Hill, & Nardi, P.C.			
Street Address 201 W. Bluff Street		City Marquette	State Mi
		ZIP 49855	
Accountant Signature 			Date 4/18/05

Audited Basic Financial Statements
Required Supplementary Information
And Other Information

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

September 30, 2004

Audited Basic Financial Statements
Required Supplementary Information
And Other Information

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

September 30, 2004

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Management's Discussion and Analysis

Northpointe Behavioral Healthcare System

Year Ended September 30, 2004

Northpointe Behavioral Healthcare Systems Authority (Northpointe) is a mental health authority located in Kingsford, Michigan, that was created under PA258 of 1974, as amended, by Act 152 of 1996 and provides mental health services to residents of Dickinson, Iron, and Menominee Counties. Northpointe is in its second year of complying with the provisions of the Governmental Accounting Standards Board Statement No. 34 (GASB 34) with the enclosed financial statements. The primary objective of GASB 34 is to enhance the understandability and usefulness of these financial statements to Board members, citizens, investors, or creditors.

Provisions of GASB 34 required Northpointe to implement the new financial reporting model for the fiscal year ending September 30, 2003. Generally, the financial information will be reported in a two-year comparative format. We encourage readers to consider the information presented here in conjunction with the audited financial statements.

Overview of the Basic Financial Statements

The Statement of Net Assets and Governmental Funds Balance Sheet and the Statement of Activities and Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balance report information about Northpointe as a whole and about its activities in a way that portrays the results of the current year's operations. Since Northpointe is being reported as a Special Purpose Government (Note A), the statements show both the Government Wide and Fund Level reporting methods. Therefore, the General Fund columns are reported on the modified accrual basis. Only those assets that are measurable and currently available are reported. Liabilities are recognized to the extent that they will be paid with current financial resources.

The Statement of Net Assets provides the basis for evaluating the capital structure of Northpointe and assessing its liquidity and financial flexibility.

The Statement of Activities presents information that shows how Northpointe's net assets changed during the year. In addition, it also measures the financial success of Northpointe over the past year and determines whether Northpointe has adequate revenues to provide for their operations.

Condensed Financial Information

The following condensed financial data presents information reflecting Northpointe's financial position and results of operations. This data is presented in a condensed format as compared to the actual financial statements. For purposes of the net asset information, current and non-current assets and liabilities are those assets and liabilities, which are collectable or due within 12 months of the statement date.

Net assets as of the year ended September 30, are as follows:

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets	\$ 3,657,459	\$ 3,449,287
Net capital assets	1,156,104	960,937
Other non-current assets	<u>305,318</u>	<u>305,171</u>
TOTAL ASSETS	<u>\$ 5,118,881</u>	<u>\$ 4,715,395</u>
LIABILITIES		
Current liabilities	\$ 2,762,953	\$ 2,270,809
Long-term liabilities	<u>819,945</u>	<u>969,306</u>
TOTAL LIABILITIES	<u>\$ 3,582,898</u>	<u>\$ 3,240,115</u>
NET ASSETS		
Investment in capital assets, net of related debt	\$ 543,847	\$ 293,952
Unrestricted	<u>992,136</u>	<u>1,181,328</u>
TOTAL NET ASSETS	<u>\$ 1,535,983</u>	<u>\$ 1,475,280</u>

Results of operations for the year ended September 30, are as follows:

	<u>2004</u>	<u>2003</u>
REVENUE		
Federal block grants	\$ 207,528	\$ 197,710
State General Fund	3,032,241	2,648,462
State/NorthCare Medicaid	9,983,383	9,898,275
Local	275,908	368,265
Charges for services	650,845	590,123
Other revenue	<u>51,856</u>	<u>102,502</u>
TOTAL REVENUE	<u>\$ 14,201,761</u>	<u>\$ 13,805,337</u>
EXPENDITURES		
Current:		
Salaries & related expenses	\$ 8,422,918	\$ 8,271,806
Operational	2,503,576	2,309,989
Contractual	3,083,334	3,066,383
Debt service:		
Interest	<u>34,388</u>	<u>32,683</u>
TOTAL EXPENDITURES	<u>\$ 14,044,216</u>	<u>\$ 13,680,861</u>
Change in net assets	157,545	124,476
Net assets at beginning of year	<u>1,378,438</u>	<u>169,476</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,535,983</u>	<u>\$ 293,952</u>

Analysis of Overall Financial Position

Balance Sheet: As of September 30, 2004, Northpointe includes several liability account items that require further explanation as follows:

- Medicaid savings Fiscal Year 2004 reported as a liability of \$1,116,480 is Medicaid funding that was not spent as of September 30, 2004, and is payable to NorthCare; Northpointe expects \$465,704 to be returned from NorthCare and be available for use in Fiscal Year 2005.
- Carry forward of Fiscal Year 2004 reported as a liability of \$139,220 is General Fund dollars not spent as of September 30, 2004, and available for use in Fiscal Year 2005.
- Act 423 funding reported as a liability in the September 30, 2003, audit report is essentially Northpointe's fund balance and has been reclassified to the net asset portion of the financial statements to more accurately reflect the nature of these funds.

Revenue: Northpointe has a high concentration of revenue from public funds with Medicaid consisting of approximately 70 percent and State General Fund approximately 22 percent of total budgeted revenue. Revenue increased by \$396,424 over 2003. The main reason for the increase was the addition of a new funding source, the Adult Benefit Waiver program reported as State General Fund. The amount Northpointe received from this program in 2004 was \$275,948. Also, Medicaid revenue increased by \$85,108 due to increased Medicaid eligible individuals in the region.

Expenditures: Northpointe continuously monitors expenditures in an effort to reduce or stabilize costs and improve services. Salaries and related expenses increased by \$151,112, which is less than 2 percent. Operational costs increased by \$193,587, which resulted from a payment to Pathways of \$198,360 for Medicaid capitation funds Northpointe received for Pathways consumers living in Menominee County. Other increases included new contracts for residential care especially for children.

Budget Analysis

Northpointe's Finance Committee and full Board of Directors review the Balance Sheet and Statement of Revenues and Expenditures on a monthly basis to ensure both revenue and expenditure targets are within acceptable variances. For the year ended September 30, 2004, Northpointe's original budget varied from the final amended budget by six percent and less than one percent for revenues and expenditures, respectively. Northpointe's board approved an amended budget in September to more accurately report the year's operations. For the year ended September 30, 2004, Northpointe's actual results varied from the final amended budget by six percent and two percent for revenues and expenditures, respectively.

Long-Term Debt

As of September 30, 2004, Northpointe had \$612,257 of outstanding notes payable and capital leases, which represents a decrease of approximately \$54,728 from the prior year. This debt results primarily from a note payable on a residential home and two capital leases for equipment (network hardware and a phone system) used in the administration building. The remaining leases are on vehicles used for operational activities. More detailed information about Northpointe's long-term liabilities is presented in Note L to the financial statements.

Capital Assets

Northpointe purchased capital assets in the amount of \$399,520 during 2004. The major additions were land and construction in progress, both of which relate to the construction of a new office facility in Menominee. No capital asset disposals occurred in 2004. A summary of the capital asset activity for the year ended September 30, 2004 is contained in Note K to the financial statements.

Economic Factors Affecting Northpointe's Future

There are several factors that could affect Northpointe in the future.

- The economy of the State of Michigan continues to struggle and may affect Northpointe in future years.
- The State of Michigan operates the Medicaid program under a waiver from the federal government, which will need to be renewed in 2005. The Michigan Department of Community Health does not expect renewal to be problematic.
- The federal government is beginning to look at the Medicaid system in an effort to reduce Medicaid expenditures; however, Northpointe does not anticipate any changes in the near future.

Contacting Northpointe's Financial Management

This financial report is designed to provide citizens, taxpayers, consumers, staff, board members, creditors, and other interested parties with a general overview of Northpointe's finances and to demonstrate Northpointe's accountability for the revenues received. If you have any questions about this report or need any additional information, please contact Northpointe's Finance Director at:

Northpointe Behavioral Healthcare System
715 Pyle Drive
Kingsford, Michigan 49802



REPORT OF INDEPENDENT AUDITORS

Board of Directors
Northpointe Behavioral Healthcare Systems
Kingsford, Michigan

We have audited the accompanying financial statements of the governmental activities of Northpointe Behavioral Healthcare Systems, (Northpointe), as of and for the year ended September 30, 2004, as listed in the table of contents. These financial statements are the responsibility of Northpointe's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of Northpointe Behavioral Healthcare Systems, as of September 30, 2004, and the changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 11, 2005, on our consideration of Northpointe's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Board of Directors
Northpointe Behavioral Healthcare Systems

The Management's Discussion and Analysis and Required Supplementary Information identified in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Makela, Tautant, Hill + Nardi, P.C.

February 11, 2005

Combined Government-Wide and Fund Financial Statements
Statement of Net Assets and Governmental Funds Balance Sheet

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

September 30, 2004

	General Fund	Total	Adjustments	Statement of Net Assets
ASSETS				
Cash:				
Unrestricted	\$ 3,298,871	\$ 3,298,871		\$ 3,298,871
Restricted	305,318	305,318		305,318
Receivables	162,477	162,477		162,477
Prepaid expenses	196,111	196,111		196,111
Land			\$ 36,700	36,700
Construction in progress			246,000	246,000
Other capital assets, net of accumulated depreciation			873,404	873,404
TOTAL ASSETS	\$ 3,962,777	\$ 3,962,777	\$ 1,156,104	\$ 5,118,881
LIABILITIES				
Accounts payable	\$ 582,090	\$ 582,090		\$ 582,090
Due to state	224,427	224,427		224,427
Medicaid savings FY2004	1,116,480	1,116,480		1,116,480
Accrued payroll and fringes	601,989	601,989		601,989
Deferred revenue	4,477	4,477		4,477
Carryforward of FY2004 revenue	139,220	139,220		139,220
Long-term liabilities:				
Accrued sick and vacation	301,958	301,958		301,958
Due within one year			\$ 94,270	94,270
Due after one year			517,987	517,987
TOTAL LIABILITIES	2,970,641	2,970,641	612,257	3,582,898
FUND BALANCES/NET ASSETS				
Fund Balances:				
Unreserved	992,136	992,136	(992,136)	
TOTAL LIABILITIES AND FUND BALANCES	\$ 3,962,777	\$ 3,962,777		
Net assets:				
Invested in capital assets, net of related debt			543,847	543,847
Unrestricted--Act 423 funds			992,136	992,136
TOTAL NET ASSETS			\$ 1,535,983	\$ 1,535,983

See notes to financial statements.

Combined Government-Wide and Fund Financial Statements
Statement of Activities and Governmental Fund Statement of Revenues,
Expenditures, and Changes in Fund Balance

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

Year Ended September 30, 2004

	General Fund	Total	Adjustments	Statement of Activities
REVENUE				
Federal block grants	\$ 207,528	\$ 207,528		\$ 207,528
State--General Fund	3,032,241	3,032,241		3,032,241
State/Northcare Medicaid	9,983,383	9,983,383		9,983,383
Local	275,908	275,908		275,908
Charges for services	650,845	650,845		650,845
Other revenues	51,856	51,856		51,856
Proceeds from borrowing	93,148	93,148	\$ (93,148)	
TOTAL REVENUE	\$ 14,294,909	\$ 14,294,909	\$ (93,148)	\$ 14,201,761
EXPENDITURES				
Current:				
Salaries & related expenses	\$ 8,422,918	\$ 8,422,918		\$ 8,422,918
Board related expenses	31,156	31,156		31,156
Office supplies & postage	60,221	60,221		60,221
Operating & program supplies	279,737	279,737		279,737
Client medical	36,514	36,514		36,514
Pharmacy	15,371	15,371		15,371
Dental	12,351	12,351		12,351
MIS support	151,862	151,862		151,862
Staff medical	16,842	16,842		16,842
Local match MRS Grant	12,244	12,244		12,244
Contract employee services	237,228	237,228		237,228
Legal, professional, accounting	29,286	29,286		29,286
The Source	(542)	(542)		(542)
Local in-patient	505,153	505,153		505,153
County in-patient	24,992	24,992		24,992
State in-patient	437,305	437,305		437,305
Home services	1,007,777	1,007,777		1,007,777
Community mental health	7,975	7,975		7,975
Pathways	20,680	20,680		20,680
Trico	450,000	450,000		450,000
Goodwill	313,779	313,779		313,779
DICSA	61,992	61,992		61,992
Crisis services	16,453	16,453		16,453
Respite	98,412	98,412		98,412
Utilities	224,197	224,197		224,197

Combined Government-Wide and Fund Financial Statements
Statement of Activities and Governmental Fund Statement of Revenues,
Expenditures, and Changes in Fund Balance--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

Year Ended September 30, 2004

	General Fund	Total	Adjustments	Statement of Activities
Staff development & travel	\$ 139,839	\$ 139,839		\$ 139,839
Vehicle operations/maintenance	204,953	204,953		204,953
Advertising/Recruitment	19,807	19,807		19,807
Liability insurance	178,592	178,592		178,592
Repairs and maintenance	219,536	219,536		219,536
Rent--facilities and equipment	358,215	358,215		358,215
Dues and publications	14,965	14,965		14,965
Pathways PHP	390,686	390,686		390,686
Miscellaneous	9,332	9,332		9,332
Capital Outlay	408,573	408,573	\$ (408,573)	
Debt Service:				
Principal	118,120	118,120	(118,120)	
Interest	34,388	34,388		34,388
TOTAL EXPENDITURES	14,570,909	14,570,909	(526,693)	14,044,216
Excess (deficit) of revenues over expenditures	(276,000)	(276,000)	276,000	
Change in net assets			157,545	157,545
Net assets at beginning of the year	1,268,136	1,268,136	110,302	1,378,438
Net assets at end of the year	<u>\$ 992,136</u>	<u>\$ 992,136</u>	<u>\$ 543,847</u>	<u>\$ 1,535,983</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

September 30, 2004

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Northpointe Behavioral Healthcare Systems (Northpointe) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local units of government through its pronouncements. Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989, that do not conflict with or contradict GASB pronouncements. The more significant policies established in GAAP and used by Northpointe are discussed below:

Background: Northpointe Behavioral Healthcare Services Board was originally formed as a merger of the Menominee County Community Mental Health Center and the Dickinson-Iron Mental Health Services Board. This merger was provided under the County Community Mental Health Program Act of 1986 and the Urban Cooperation Act of 1967, as amended, and was effective January 1, 1995. In accordance with the agreement, each center transferred all existing assets and contracts to the new authority. Northpointe Behavioral Healthcare Systems ("Northpointe" or "Board") was reorganized as an authority under PA258 of 1974, as amended, by Act 152 of 1996, effective January 6, 1998. The authority is covered under Section 205 2(e) of the Mental Health Code.

Northpointe's Board of Directors are appointed by the respective county boards of commissioners, and consist of five members each from Menominee County and Dickinson County and two members from Iron County. Northpointe was formed to provide a full range of mental health services for residents located within the three counties as required and permitted by the Michigan Mental Health Code.

Reporting Entity: Because Northpointe is a separate entity under PA 258 of 1974, as amended, and is governed by a board composed of members from each of the three counties, it has been defined as a jointly governed organization by GASB Statement 14. No county board has responsibility over Northpointe nor does any county board have an on-going financial interest in Northpointe as defined by GASB Statement 14. Northpointe is not a component unit of any of the three counties it serves.

The accounting policies of Northpointe conform to accounting principles generally accepted in the United States of America as applicable to mental health centers. The following is a summary of the more significant policies.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Basic Financial Statements—Combined Government-wide and Fund Financial Statements—Statement of Net Assets and Governmental Funds Balance Sheet

In the Combined Government-wide and Fund Financial Statements—Statement of Net Assets and Governmental Fund Balance Sheet, the General Fund column is presented on the fund financial statement basis. The “Adjustments” column represents the items needed to convert the financial statements to the government-wide reporting basis. The Statement of Net Assets column represents amounts that normally would appear in the government-wide statements. Northpointe’s net assets are reported as either invested in capital assets, net of related debt, restricted, or unrestricted.

Basic Financial Statements—Combined Government-wide and Fund Financial Statements—Statement of Activities and Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance.

In the Combined Government-wide Fund Financial Statements—Statement of Activities and Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance, the General Fund column is presented on the fund financial statement basis. The “Adjustments” column represents the items needed to convert the financial statements to the government-wide reporting basis. The Statement of Activities column represents amounts that normally would appear in the government-wide statements. Northpointe’s change in net assets for the current year is presented in the adjustments column and the Statement of Activities column. This statement also presents the beginning and end of year net assets.

Governmental Funds: The focus of the governmental funds’ measurement is upon the determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income. The following is a description of the governmental funds of Northpointe:

General Fund: The General Fund is the primary operating fund and, accordingly, it is used to account for all financial resources except those accounted for in another fund.

Basis of Accounting

The basis of accounting refers to the point at which revenues and expenditures/expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied.

Governmental activities in government-wide financial statements are presented on the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Governmental fund financial statements are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual; that is, when both measurable and available. "Available" means collectible within the current period or within sixty days after year-end. Expenditures are generally recognized under the modified accrual basis of accounting when the related liability is incurred, except for principal and interest on general obligation debt, if any, is recognized when due.

As allowed by GASB Statement No. 34, Northpointe's financial statements are presented as a Special Purpose Government. Northpointe is a government authority that provides a specific activity to the public in the form of mental health services. Since Northpointe's financial statements are presented as a Special Purpose Government, the basic financial statements were prepared by combining the fund financial statements with the government-wide statements. This combination is presented in a balance sheet and income statement format, using an "Adjustment" column for the conversion from the fund basis to the government-wide basis.

Financial Statement Amounts

Cash and Cash Equivalents: Northpointe has defined cash and cash equivalents to include cash on hand and demand deposits.

Capital Assets: Capital assets purchased or acquired with an original cost of \$5,000 or more are reported at historical cost or estimated historical cost. Contributed assets, if any, are reported at fair market value as of the date received. Additions, improvements, and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on all assets is provided on the straight-line basis. General capital assets are those that result from expenditures in the governmental funds. These assets are reported in the Statement of Net Assets column of the Statement of Net Assets and Governmental Funds Balance Sheet.

The expenditures for these assets are reported as Capital Outlay Expenditures in the General Fund column of the Statement of Activities and Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance. These expenditures are then deducted in the "Adjustments" column to convert the statement to the government-wide basis.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Accrued Liabilities and Long-Term Obligations: Payables and accrued liabilities that will be paid from governmental funds are reported in the General Fund column of the Statement of Net Assets and Governmental Funds Balance Sheet regardless of whether they will be liquidated with current financial resources. The non-current portion of compensated absences, that will be paid from governmental funds are reported as a liability in this same statement only to the extent that they will be paid with current, expendable, available financial resources (generally, within sixty days of year-end).

Deferred Revenue: Northpointe reports deferred revenue when revenue does not meet both the "measurable" and "available" criteria for recognition in the current period, or when resources are received by Northpointe before it has a legal claim to them, such as when grant money is received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when Northpointe has legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized.

Net Assets: Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction, or improvement of those assets. Net assets are reported as restricted only when there are limitations imposed on their use through enabling legislation or through external restrictions imposed by creditors, grantors, laws, or other government regulation. In addition, Northpointe will first use restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B--CASH

The cash balance as reported in the Statement of Net Assets and Governmental Funds Balance Sheet is presented below:

	<u>Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Cash in bank	\$ 305,318	\$ 3,296,720	\$ 3,602,038
Cash on hand		2,151	2,151
	<u>\$ 305,318</u>	<u>\$ 3,298,871</u>	<u>\$ 3,604,189</u>

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

Statutory Authority

Act 196, PA 1997, authorizes Northpointe to deposit and invest in:

1. Bonds, securities, and other direct obligations of the United States or an agency or instrumentality of the United States.
2. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a financial institution eligible to be a depository of funds belonging to the State of Michigan under a law or rule of this state or the United States.
3. Commercial paper rated at time of purchase within the two highest classifications established by, not less than two, standard rating services and that matures not more than 270 days after the date of purchase.
4. Repurchase agreements consisting of instruments issued by the United States or an agency or instrumentality of the United States.
5. Banker's acceptance of United States banks.
6. Obligations of the State of Michigan or any of its political subdivisions, that at the time of purchase, are rated as investment grade by not less than one standard rating service.
7. Mutual funds registered under Investment Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation.

All deposits are carried at cost, which approximates market value, and are in accordance with statutory authority. The deposits are categorized to give an indication of the level of risk assumed by Northpointe. The categories are described as follows:

Category 1: Insured or collateralized with securities held by the entity or by its agent in the entity's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Category 3: Uncollateralized.

The total cash deposits held in financial institutions at September 30, 2004, is \$3,697,290, of which the Federal Deposit Insurance Corporation (FDIC) under Regulation Number 330.8 (Category 1) insures \$150,598. The remaining \$3,546,692 is uninsured and uncollateralized (Category 3). This regulation, in summary, provides that deposits of a governmental unit are insured for the lesser of the amount of the combined deposit or \$100,000 for both interest bearing and non-interest bearing deposits in every financial institution that is not a branch location which is a member of the FDIC.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE C--RESTRICTED CASH

As reported on the Statement of Net Assets and Governmental Funds Balance Sheet, Northpointe has restricted cash of \$305,318. This includes \$301,958 for accumulated sick and vacation pay and \$3,360 for the Internal Revenue Code Section 125 medical reimbursement plan.

NOTE D--RECEIVABLES

Detail of the receivable balance at September 30, 2004, is as follows:

Federal grants	\$	31,579
State grants		12,024
Medicaid		99,717
Patient fees		16,531
Miscellaneous		<u>2,626</u>

TOTAL RECEIVABLES \$ 162,477

An allowance for doubtful accounts has not been established since all amounts are fully collectible. In the event that an amount becomes uncollectible, the receivable and the corresponding revenue are eliminated.

NOTE E--PENSION PLANS

Plan Descriptions

For the year ended September 30, 2004, Northpointe had two pension plans with five divisions. The first plan is a defined contribution money purchase pension plan administered by the ICMA Retirement Corporation. The first division is for union unit one, which consists of hourly employees. This division has a three percent employer and zero percent employee contribution with a five-year vesting schedule. The second division is for former Menominee County mental health clinic non-union employees and Northpointe non-union employees hired after the January 1, 1995, merger date. This division has a seven percent employer and zero percent employee contribution with a five-year vesting schedule. Both divisions have minimum service requirements of twelve months of credited service and eighteen years of age. This plan's five-year vesting schedule allows twenty percent vesting each year.

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE E--PENSION PLANS--Continued

The second plan maintained by Northpointe is through the Michigan Municipal Employee's Retirement System ("System" or "MERS"), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for Michigan municipal employees. MERS issues a publicly available financial report that includes the financial statements and required supplementary information for the entire System. The report may be obtained by writing to MERS, 1134 Municipal Way, Lansing, Michigan 48917.

Defined Contribution Plan

MERS administers two types of pension plans for Northpointe. The first plan is a defined contribution plan covering the chief executive officer, who is immediately eligible for the plan, which has a seven percent employer and zero percent employee contribution requirement. The plan's five-year vesting schedule allows twenty percent vesting each year.

Defined Benefit Plan

The second plan is a defined benefit plan that covers two groups of employees under separate provisions. The first group is non-union original employees from the Dickinson-Iron Community Mental Health Services Board (Board) prior to the merger.

The employees who retire at or after the age of 60 with ten years of credited service are entitled to an annual retirement benefit, payable monthly for life, in the amount equal to the sum of 2.25 percent times the member's five-year final average compensation, with a maximum benefit of 80 percent of final average compensation. The plan also provides death and disability benefits.

Employees contribute two percent of their salary to the plan with the Board making up the rest of the contribution, which is actuarially determined. The employee's portion is fully vested immediately; the Board's portion is vested after ten years of credited service. The Board's portion is immediately vested, however, if the employee dies or becomes disabled while on the job.

The second group of employees covered under the MERS program is unit two employees. This group has no employee contribution requirement. The Board's contribution vests to the employee after six years of credited service and the annual retirement benefit multiplier is two percent. All other terms are consistent with the plan for non-union employees described above.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE E--PENSION PLANS--Continued

Funding Status and Progress

The amount shown below as the "actuarial accrued liability" represents the difference between the present value of all future benefits and the present value of future normal costs. The overfunded actuarial liability, which represents the actuarial accrued liability less assets accumulated, is then amortized over a period of thirty years. The measure over time is intended to help users assess the funding status of the System on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and allow for comparisons among public employee retirement plans.

Under the entry age normal cost method, the total actuarially-determined contribution requirement is the sum of the normal cost and the payment required to amortize the unfunded accrued liability less the accelerated funding credits, if any.

At December 31, 2003, the over funded actuarial accrued liability was \$779,859, determined as follows:

Actuarial Accrued Liability:

Retirees and beneficiaries currently receiving benefits	\$ 1,244,784
Terminated employees not yet receiving benefits	606,657
Non-vested terminated employees	37,021
Current employees:	
Accumulated employee contributions including allocated investment earnings	508,754
Employer financed	2,657,538
TOTAL ACTUARIAL ACCRUED LIABILITY	5,054,754
Net assets available for benefits, at actuarial value (market value--\$5,327,630)	5,834,613
OVERFUNDED ACTUARIAL ACCRUED LIABILITY	\$ (779,859)

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE E--PENSION PLANS--Continued

Actuarially Determined Contributions Required and Contributions Made

Periodic employer contributions are determined on an actuarial basis using the entry age normal cost method. Normal cost is funded on a current basis whereas over funded actuarial accrued liability is funded over a thirty-year period. Periodic contributions for both normal cost and the amortization of the over funded actuarial accrued liability are based on the level percentage of payroll method. The actuarial assumptions used include (a) a rate of return on the investment of 8% per year for present and future assets, (b) projected salary increases of 4.5% per year, compounded annually, attributable to inflation, and (c) additional projected salary increases based upon seniority and merit.

Total voluntary contributions to the pension plan in the year ended September 30, 2004, (made by Northpointe's employees) totaled \$17,902. Since the plan has an overfunded accrued liability, Northpointe did not contribute to the plan during 2004. The contributed amounts were actuarially determined based on an actuarial valuation as of December 31, 2003. Contributions made by its employees represent .72% of covered payroll for the year.

Analysis of Funding Progress

Actuarial Valuation December 31	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	(Overfunded) Accrued Liability	Funded Ratio	Annual Covered Payroll	UAL as a Percentage of covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	[(b-a)/c]
2001	\$ 5,441,388	\$ 3,956,795	\$ (1,484,593)	138%	\$ 2,394,391	0%
2002	5,508,256	4,396,919	(1,111,337)	125%	2,470,820	0%
2003	5,834,613	5,054,754	(779,859)	115%	2,499,582	0%

NOTE F--VESTED EMPLOYEE BENEFITS

All employees of Northpointe are entitled to accrue vacation and sick pay benefits. Employees begin to accrue benefits upon initial employment and can accumulate vacation benefits as follows: CEO - 30 days, exempt and non-exempt staff - 25 days. Sick leave benefits accrue up to a limit of 120 days for all employees. Upon termination of employment, employees are entitled to receive 100 percent of their accrued vacation leave. Sick leave would be paid out to any employee upon termination at a rate of 50 percent of their accrued leave over 60 days up to 120 days at their current rate of pay. Presently, no one has achieved these criteria. Accordingly, no accrual for sick leave has been recorded in the General Fund. As of September 30, 2004, the Board has restricted cash in the amount of \$301,958 to fund future vacation and sick pay benefits.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE G--DUE TO STATE

Due to State at September 30, 2004, is as follows:

In-patient facilities	\$ 133,098
Cash advances	<u>91,329</u>
TOTAL	<u><u>\$ 224,427</u></u>

NOTE H--LEASE COMMITMENTS

Northpointe has entered into a number of non-cancelable operating leases for facilities with varying terms and conditions. Required minimum payments for the fiscal years ending September 30 are as follows:

2005	\$ 140,757
2006	124,754
2007	84,617
2008	54,237
2009	54,237
2010-2014	<u>110,103</u>
TOTALS	<u><u>\$ 568,705</u></u>

NOTE I--DEFERRED REVENUE

Deferred revenue at September 30, 2004, is as follows:

Prevention	\$ 2,780
SSI Clients	<u>1,697</u>
	<u><u>\$ 4,477</u></u>

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE J--OTHER LIABILITIES

Medicaid liability	\$ 1,116,480
Carryforward of FY2004 revenue	<u>139,220</u>
	<u>\$ 1,255,700</u>

The Medicaid Savings liability as of September 30, 2004, in the amount of \$1,116,480 represents Medicaid funding not spent in fiscal year 2004 and is available for expenditure in fiscal year 2005. The carryforward of FY2004 revenue liability of \$139,220 represents State of Michigan General Fund dollars not spent in fiscal year 2004 and is available for expenditure in fiscal year 2005.

NOTE K--CAPITAL ASSETS

Capital asset activity for the year ended September 30, 2004, was as follows:

	Balance at October 1, 2003	Additions	Deletions	Balance at September 30, 2004
Non-depreciated capital assets:				
Land	\$ 6,700	\$ 30,000		\$ 36,700
Land improvements		5,092		5,092
Other capital assets:				
Buildings	647,799			647,799
Construction in progress		246,000		246,000
Equipment	796,142	30,372		826,514
Vehicles	813,559	93,148		906,707
Subtotal	<u>2,257,500</u>	<u>369,520</u>	<u>\$ 0</u>	<u>2,627,020</u>
TOTAL CAPITAL ASSETS	2,264,200	404,612	0	2,668,812
Accumulated depreciation:				
Land improvements		85		85
Buildings	153,412	26,102		179,514
Equipment	457,133	109,520		566,653
Vehicles	699,418	67,038		766,456
Subtotal	<u>1,309,963</u>	<u>202,660</u>	<u>0</u>	<u>1,512,708</u>
NET CAPITAL ASSETS	\$ 954,237	\$ 201,952	\$ 0	\$ 1,156,104

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE L--LONG-TERM DEBT

Long-term debt represents the following as of September 30, 2004:

Description	Carrying Amount
Notes Payable	
Note payable, secured by real estate, due in monthly installments of \$2,199, through June 2007, including interest at 5.05%.	\$ 278,140
TOTAL NOTES PAYABLE	\$ 278,140
Capital Lease Obligation	
Capital lease payable, secured by a vehicle, due in monthly installments of \$342, through September 2007, including interest at 4.93%.	\$ 11,103
Capital lease payable, secured by a vehicle, due in monthly installments of \$263, through September 2007, including interest at 4.93%.	8,553
Capital lease payable, secured by a vehicle, due in monthly installments of \$263, through September 2007, including interest at 4.93%.	8,553
Capital lease payable, secured by a vehicle, payable in monthly installments of \$571, through June 2009, including interest at 6.263%.	28,073
Capital lease payable, secured by a vehicle, payable in monthly installments of \$359, through December 2008, including interest at 5.29%.	16,350
Capital lease payable, secured by a vehicle payable in monthly installments of \$657, through December 2005, including interest at 7.899%.	9,423
Capital lease payable, secured by a vehicle, payable in monthly installments of \$568, through December 2005, including interest at 7.75%.	8,142

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE L--LONG-TERM DEBT--Continued

Description	Carrying Amount
Capital lease payable, secured by a vehicle, payable in monthly installments of \$378, through January 2005, including interest at 6.46%.	\$ 1,510.00
Capital lease payable, secured by a vehicle, payable in monthly installments of \$499, through January 2005, including interest at 6.46%.	2,466
Capital lease payable, secured by a vehicle, payable in monthly installments of \$306, through December 2008, including interest at 5.00%.	14,013
Capital lease payable, secured by a vehicle, payable in monthly installments of \$242, through December 2008, including interest at 5.00%.	11,074
Capital lease payable, secured by a vehicle, payable in monthly installments of \$321, through October 2009, including interest at 6.85%.	16,248
Capital lease payable, secured by equipment, payable in monthly installments of \$177, through August 2007, including interest at 11.556%.	5,231
Capital lease payable, secured by equipment, payable in monthly installments of \$2,005, through May 2010, including interest at 4.97%.	118,601
Capital lease payable, secured by equipment, payable in monthly installments of \$2,085, through December 2007, including interest at 5.12%.	<u>74,777</u>
TOTAL CAPITAL LEASE OBLIGATION	<u>334,117</u>
TOTAL LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION	<u><u>\$ 612,257</u></u>

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE L--LONG-TERM DEBT--Continued

Future minimum payments of the notes payable and capital lease obligations are as follows:

<u>Fiscal Year Ended September 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 94,270	\$ 29,790	\$ 124,060
2006	84,778	24,766	109,544
2007	335,106	18,160	353,266
2008	47,986	3,911	51,897
2009	34,055	1,715	35,770
2010-2014	<u>16,062</u>	<u>298</u>	<u>16,360</u>
TOTAL	<u>\$ 612,257</u>	<u>\$ 78,640</u>	<u>\$ 690,897</u>

The following is a summary of the long-term debt activity as of September 30, 2004:

	<u>September 30, 2003</u>	<u>Additions</u>	<u>Payments</u>	<u>September 30, 2004</u>
Notes payable	\$ 338,024		\$ (59,884)	\$ 278,140
Capital lease obligations	<u>328,961</u>	<u>\$ 93,148</u>	<u>(87,992)</u>	<u>334,117</u>
TOTAL LONG-TERM DEBT	<u>\$ 666,985</u>	<u>\$ 93,148</u>	<u>\$(147,876)</u>	<u>\$ 612,257</u>

NOTE M--RISK MANAGEMENT

Northpointe participates as a member in the Michigan Municipal Risk Management Authority (Authority). The Authority is a municipal self-insurance entity operating pursuant to the State of Michigan Public Act 138 of 1982. The purpose of the Authority is to administer a risk management fund, which provides members with loss protection for general and auto liability, motor vehicle physical damage, and property.

The Authority has entered into reinsurance agreements providing for loss coverage in excess of the amounts to be retained by the Authority and individual members.

NOTES TO FINANCIAL STATEMENTS--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

NOTE M--RISK MANAGEMENT--Continued

In the event a reinsurance company does not meet its obligation to the Authority, responsibility for payment of any unreimbursed claims will be that of the Authority Reinsurance Fund. The Authority has retained certain levels of risk rather than obtaining coverage through reinsurance agreements. The authority established the Authority Reinsurance Fund in order to participate in the reinsurance agreements. Individual members are provided the same level of coverage previously afforded through a combination of the reinsurance agreements and the Reinsurance Fund. In addition, the Authority purchases insurance for certain risks not covered by the reinsurance agreements. At September 30, 2004, Northpointe has no outstanding claims which exceed the plan's limits and there has been no significant reduction in insurance coverage over the past three years.

NOTE N--CONCENTRATIONS

Northpointe derives a significant portion of their total support and revenues from the Michigan Department of Community Health (MDCH) through Medicaid and Public Act 258 funding. Revenue and support recognized for the year ended September 30, 2004, provided by MDCH represented approximately 92 percent of Northpointe's total support and revenue.

NOTE O--COMMITMENTS

Northpointe Behavioral Healthcare Systems is in the process of constructing a new building in the Menominee area. Northpointe has signed a construction contract in the amount of \$756,000. As of September 30, 2004, Northpointe had been billed approximately \$246,000, leaving a contract balance of \$510,000.

REQUIRED SUPPLEMENTARY INFORMATION

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL--GENERAL FUND

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

Year Ended September 30, 2004

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
REVENUE				
Federal block grants	\$ 173,410	\$ 201,763	\$ 207,528	\$ 5,765
State--General Fund	3,235,870	3,255,966	3,032,241	(223,725)
State/Northcare Medicaid	9,722,400	10,660,704	9,983,383	(677,321)
Local	366,382	377,726	275,908	(101,818)
Charges for services	761,600	711,100	650,845	(60,255)
Other revenues	68,997	30,325	51,856	21,531
Proceeds from borrowing			93,148	93,148
TOTAL REVENUE	<u>\$ 14,328,659</u>	<u>\$ 15,237,584</u>	<u>\$ 14,294,909</u>	<u>\$ (942,675)</u>

EXPENDITURES

Current:

Salaries & related expenses	\$ 8,530,417	\$ 8,514,500	\$ 8,422,918	\$ 91,582
Board related expenses	29,580	33,120	31,156	1,964
Office supplies & postage	81,546	75,000	60,221	14,779
Operating & program supplies	279,680	256,000	279,737	(23,737)
Client medical	66,900	40,000	36,514	3,486
Pharmacy	10,200	18,000	15,371	2,629
Dental	10,200	15,000	12,351	2,649
MIS Support	210,504	210,000	151,862	58,138
Staff medical	30,000	20,000	16,842	3,158
Local match MRS Grant	33,876	12,300	12,244	56
Contract employee services	238,080	245,000	237,228	7,772
Legal, professional, accounting	143,500	25,600	29,286	(3,686)
The Source	14,640	10,000	(542)	10,542
Local in-patient	633,554	600,000	505,153	94,847
County in-patient	36,000	25,000	24,992	8
State in-patient	282,660	440,000	437,305	2,695
Home services	1,213,020	1,034,400	1,007,777	26,623

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL--GENERAL FUND--Continued

NORTHPOINTE BEHAVIORAL HEALTHCARE SYSTEMS

Year Ended September 30, 2004

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Community mental health	\$ 7,200	\$ 7,500	\$ 7,975	\$ (475)
Pathways	52,000	20,000	20,680	(680)
Trico	431,800	450,000	450,000	
Goodwill	241,200	315,000	313,779	1,221
DICSA	62,004	62,000	61,992	8
Crisis services	16,920	16,905	16,453	452
Respite	104,680	104,680	98,412	6,268
Utilities	259,362	254,000	224,197	29,803
Staff development & travel	164,340	145,000	139,839	5,161
Vehicle operations/maintenance	163,020	195,000	204,953	(9,953)
Vehicle leases/purchases	59,100	60,000		60,000
Advertising	19,500	24,500	19,807	4,693
Liability insurance	106,764	175,000	178,592	(3,592)
Repairs and maintenance	226,376	263,000	219,536	43,464
Rent--facilities and equipment	415,756	412,000	358,215	53,785
Dues and publications	18,300	18,000	14,965	3,035
Pathways PHP	128,760	192,000	390,686	(198,686)
Miscellaneous	7,200		9,332	(9,332)
Capital Outlay			408,573	(408,573)
Debt Service:				
Principal			118,120	(118,120)
Interest			34,388	(34,388)
TOTAL EXPENDITURES	14,328,639	14,288,505	14,570,909	(282,404)
Change in net assets	20	949,079	(276,000)	(1,225,079)
Net assets at beginning of the year			1,268,136	1,268,136
Net assets at end of the year	\$ 20	\$ 949,079	\$ 992,136	\$ 43,057

OTHER INFORMATION



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Directors
Northpointe Behavioral Healthcare Systems
Kingsford, Michigan

We have audited the financial statements of Northpointe Behavioral Healthcare Systems, as of and for the year ended September 30, 2004, and have issued our report thereon dated February 11, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Northpointe Behavioral Healthcare System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Northpointe Behavioral Healthcare System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



Board of Directors
Northpointe Behavioral Healthcare Systems

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Makela, Tautant, Hill & Nardi, P.C.

February 11, 2005